89-1557

No.

IN THE
Supreme Court of the United States
October Term, 1989

SAMUEL I. SHUMAN, *et al.*,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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April 5, 1990

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QUESTION PRESENTED

Where the district court in a non-jury action has considered a motion for summary judgment opposed by expert testimony and concluded that the foundation and content of that testimony fails to establish a material issue of fact as to an essential element of the case upon which the opposing party bears the burden of proof, should the district court's decision to grant summary judgment be sustained unless manifestly erroneous?

PARTIES TO THE PROCEEDING

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Petitioner,

Adrian M. Shapiro
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Petitioner,

TEXANNA ART TRADING COMPANY, INC.
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Petitioner,

and

THE UNITED STATES OF AMERICA

Respondent.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases: Page

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Samuel I. Shuman, Adrian M. Shapiro and TEXANNA ART TRADING CO., INC. (hereinafter "the taxpayers") petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit reversing the Order of the United States District Court for the Southern District of Texas at Houston granting taxpayers' motion for summary judgment, and remanding the case to the district court for further proceedings (Appendix E, *infra*) is reported. The opinions of the District Court granting taxpayers' motion for summary judgment (Appendix A, *infra*), and final judgment (Appendix B, *infra*) are not reported.

JURISDICTION

The order of the United States Court of Appeals for the Fifth Circuit sought to be reviewed was entered on January 5, 1990. This Court's jurisdiction is invoked pursuant to 28 U.S.C. §1254(1). Jurisdiction over taxpayers' refund suit in the United States

District Court for the Southern District of Texas was based upon 28 U.S.C. §1346(a)(1) and 26 U.S.C. §6703(c)(2).

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

Rule 56, Fed. R. Civ. Proc. (Appendix F, *infra*).

STATEMENT

In September of 1982, taxpayer TEXANNA Art Trading Co., Inc. ("TEXANNA") issued a private information memorandum describing an offering whereby TEXANNA had purchased art masters, reproduction rights and related copyrights to various works of art. TEXANNA then made the original lithographic or seriographic plates available to prospective buyers, who were advised to obtain at least two qualified appraisals stating that the purchase price paid for the art masters was at least equal to their fair market value, and that subsequent to

purchase, the buyers could expect to recover their costs and obtain a reasonable return on the production and marketing of limited and unlimited edition prints, reproductions and ancillary products. Sixteen master plates were eventually sold to individual investors, with the purchase prices paid by a combination of cash, short and long-term promissory notes.

On August 31, 1984, the Internal Revenue Service made a determination that the taxpayers were promoting an "abusive tax shelter" as defined by §6700 of the Internal Revenue Code of 1954 (26 U.S.C.) (hereinafter, I.R.C.).[1] IRC §6700 provides

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[1] The tax year at issue in this case antedates the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, section 2 of which redesignates the former "Internal Revenue Code of 1954" as the "Internal Revenue Code of 1986." Unless otherwise provided, references to Internal Revenue Code provisions will be to the Internal Revenue Code of 1954.

for the imposition of penalties against individuals where it can be proven that a person or entity (1) organizes or participates in the sale of an abusive tax shelter; and (2) makes or furnishes a statement in connection with such activity that is either false or fraudulent or is a "gross valuation understatement."[2] For purposes of I.R.C. §6700, a "gross valuation understatement" means any statement as to the value of any property or services if (a) the value so stated exceeds 200 percent of the amount determined to be the correct valuation; and (b) the value of said property or services is directly related to the amount of any deduction or credit allowable. (I.R.C. §6700(b)(1)(A),(B)). In any proceeding

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[2] The government conceded during discovery that the penalty asserted against taxpayers was based exclusively on an alleged "gross valuation overstatement" and not on a false or fraudulent statement.

involving the issue of the liability of any person allegedly liable for a penalty under I.R.C. §6700, the burden of proof with respect to such issue shall be on the Secretary of the Treasury. (I.R.C. §6703(a)).

On April 8, 1985, taxpayers filed a complaint in the United States District Court for the Southern District of Texas. Taxpayers' action sought an abatement of the assessments levied by the IRS pursuant to I.R.C. §6700, as well as refund of the partial payments (15% of the total assessments) paid by the taxpayers as a predicate to the maintenance of the suit, plus interest, costs, and attorney's fees.

On May 15, 1987, the district court filed a conference memorandum indicating that (1) the government was to deliver its expert report (concerning the value of the art master plates) to the taxpayers, to be followed thereafter by taxpayers' report to

the government; and (2) that the only issues remaining to be addressed pertained to the issue of valuation and the role of taxpayer Shuman in the alleged enterprise, said issues to be addressed by motion first. On September 21, 1987, the district court filed an additional conference memorandum indicating that no rulings were made but that the parties would attempt to submit the remaining issues on cross-motions for summary judgment.

On October 19, 1987, the taxpayers filed a motion for summary judgment, the disposition of which is the subject of this petition. By their motion, taxpayers alleged (1) they were entitled to judgment as a matter of law, since the government had failed to carry its burden of establishing an overvaluation of the art master plates; and (2) that taxpayer Shapiro was entitled to summary judgment because he was not a person

who organized or assisted in the organization of a tax shelter, as required for liability to attach pursuant to I.R.C. §6700.[3]

On the issue of valuation, the taxpayers' motion was principally directed to the sufficiency of the report filed by the government's expert to establish a material issue of fact as to the value of the art master plates, an essential element of the case upon which the government bore the burden of proof. Specifically, taxpayers contended that the government's expert had presented only a hearsay evaluation of a hypothetical business or business franchise, but had failed to raise any issue as to valuation of the plates due to the expert's conclusion that "[S]imilarly, no value can be

---

[3] As the district court granted all taxpayers' Motions for Summary Judgment on the issue of valuation, the secondary issue raised by taxpayer Shapiro was not addressed by the district court.

estimated for the 'masters' or 'master-plates', since such estimates -- as they relate to enterprise -- would be speculative."

On November 9, 1987, the government filed an opposition to the taxpayers' motion for summary judgment as well as a cross-motion for summary judgment. Notwithstanding the language contained in the government's report indicating that "no value" could be estimated for the plates, the government contended that its expert had not expressed an inability to value the plates. In addition, the government provided a second affidavit from its expert stating that he had not intended to convey an inability to value the plates in his report, and that the plates had "no value."

On September 6, 1989, a hearing was held on the cross-motions for summary judgment in the United States District Court

for the Southern District of Texas. At the conclusion of that hearing, the district court found that the government's expert report had failed to raise a material issue of fact as to valuation of the plates, a matter upon which the government bore the burden of proof. Thereupon the court entered judgment on behalf of taxpayers. (Appendix A, B).

On October 26, 1988, the government filed an appeal to the United States Court of Appeals for the Fifth Circuit. On February 22, 1988, taxpayers filed an appeal seeking review of the district court's denial of taxpayer's application for litigation costs and attorney's fees. Subsequently, the two appeals were consolidated for purposes of briefing and argument. By decision dated January 5, 1990, the Court of Appeals held that the district court had committed reversible error in granting summary

judgment, and remanded the case to the district court for further proceedings. (Appendix E).

REASONS FOR GRANTING THE WRIT

I. **THIS COURT'S DECISIONS CONCERNING THE STANDARDS TO BE APPLIED ON CONSIDERATION OF A MOTION FOR SUMMARY JUDGMENT REQUIRE SUMMARY JUDGMENT TO BE GRANTED WHERE THE NON-MOVING PARTY FAILS TO MAKE A SUFFICIENT SHOWING TO ESTABLISH A GENUINE ISSUE OF FACT ON THOSE ISSUES WITH RESPECT TO WHICH THAT PARTY HAS THE BURDEN OF PROOF. THE DISTRICT COURT HAS BROAD DISCRETION TO DETERMINE THE ADMISSIBILITY OF EXPERT TESTIMONY PROFFERED IN OPPOSITION TO A MOTION UNDER RULE 56(C). AS APPLIED TO A BENCH TRIAL, THE DECISION OF THE COURT BELOW CONTRAVENES THE ABOVE WELL ESTABLISHED LAW AS WELL AS ITS OWN DECISIONS CONCERNING DISTRICT COURT REVIEW OF EXPERT TESTIMONY.**

In Celotex Corp. v. Catret, 477 U.S. 317 (1986), this Court reviewed the standards to be applied by the federal courts for consideration of the entry of summary judgment pursuant to Federal Rule of Civil

Procedure 56(c). The opinion of the Court set forth the following analysis:

> In our view, the plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. In such a situation, there can be 'no genuine issue as to any material fact,' since a complete failure of proof concerning an essential element of the non-moving party's case necessarily renders all other facts immaterial. The moving party is 'entitled to judgment as a matter of law' because the non-moving party has failed to make a sufficient showing on an essential element of her case with respect to which she has the burden of proof.

Celotex, *Id.*, at 323, 324.

In Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986), this Court further examined the issue of summary judgment standards and the proper scope of the trial

judge's inquiry. Writing for the Court, Mr. Justice White included the following:

> The Court has said that summary judgment should be granted where the evidence is such that it 'would require a directed verdict for the moving party.' Sartor v. Arkansas Gas Corp., 321 U.S. 620, 624, 88 L. Ed. 967, 64 S.Ct. 724 (1944). And we have noted that the 'genuine issue' summary judgment standard is 'very close' to the 'reasonable jury' directed verdict standard: 'The primary difference between the two motions is procedural; summary judgment motions are usually made before trial and decided on documentary evidence, while directed verdict motions are made at trial and decided on the evidence that has been admitted.' Bill Johnson's Restaurant's, Inc. v. NLRB, 461 US 731, 745, n 11, 76 L.Ed. 2d 277, 103 S.Ct. 2161 (1983). In essence, though, the inquiry under each is the same: whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law.
>
> Progressing to the specific issue in this case, we are convinced that the inquiry involved in a ruling on a motion for summary judgment or for a directed verdict necessarily implicates the substantive evidentiary standard of proof that

> would apply at the trial on the merits. If the defendant in a run-of-the-mill civil case moves for summary judgment or for a directed verdict based on the lack of proof of a material fact, the judge must ask himself not whether he thinks the evidence unmistakably favors one side or the other but whether a fair-minded jury could return a verdict for the plaintiff on the evidence presented. The mere existence of a scintilla of evidence in support of the plaintiff's position will be insufficient; there must be evidence on which the jury could reasonably find for the plaintiff. The judge's inquiry, therefore, unavoidably asks whether reasonable jurors could find by a preponderance of the evidence that the plaintiff is entitled to a verdict -- 'whether there is [evidence] upon which a jury can properly proceed to find a verdict for the party producing it, upon whom the onus of proof is imposed.' Munson, *supra*, at 448, 20 L.Ed. 867.

Anderson, *Id.*, at 251, 252, citing Improvement Co. v. Munson, 14 Wall 442, 448, 20 L.Ed. 867 (1872).

In the instant case, which did not contemplate a jury trial but instead would have been tried before the court, the

government bore the burden of proof in establishing that the taxpayers made or furnished a statement of value for the art master plates in excess of two hundred percent of their fair market value. In order to meet its burden of proof in this respect, at the conclusion of discovery, the government advanced an expert report which the district court expressly found provided no basis upon which the judge could make a determination that the taxpayer's had in fact made or furnished gross valuation overstatements as defined by the operative statute.

In Salem v. United States Van Lines Co., 370 U.S. 31, 35 (*reh. denied*, 370 U.S. 965) (1962) this Court stated:

> . . . the trial judge has broad discretion in the matter of the admission or exclusion of expert evidence, and his action is to be sustained unless manifestly erroneous. Spring Co. v. Edgar, 99 US 645 658 (1878).

Mr. Justice Clifford, writing for the Court in Spring Co., *supra*, at 658, explained the proper approach as follows:

> Whether a witness is shown to be qualified or not as an expert is a preliminary question to be determined in the first place by the court; and the rule is, that if the court admits the testimony, then it is for the jury to decide whether any, and if any what, weight is to be given to the testimony. Cases arise where it is very much a matter of discretion with the court whether to receive or exclude the evidence, but the appellate court will not reverse in such a case, unless the ruling is manifestly erroneous.

The decision of the Court of Appeals in this action is deficient in that it (1) failed to properly apply this Court's decisions concerning entry of summary judgment and (2) failed to provide appropriate deference to the trial judge's exercise of discretion with respect to the evidentiary significance of expert testimony. In addition, the Court of Appeals also failed

to follow its own decisions concerning these same issues, and has thereby created an untenable anomaly which prevents consistent application of this Court's decisions to non-jury actions where expert testimony is required to rebut an application for summary judgment.

First, it is clear that the Court of Appeals for the Fifth Circuit has consistently followed this Court's decision in Salem, *supra*, and has serially held that in considering a summary judgment motion opposed by expert testimony, a district court has broad discretion to rule on the admissibility of the evidence and that such ruling shall be sustained unless manifestly erroneous. *See*, Rodriguez v. Olin Corp., 780 F.2d 491, 494 (5th Cir. 1986); Crawford v. Worth, 477 F.2d 738, 740-741 (5th Cir. 1971); Washington v. Armstrong World Industries, Inc., 839 F.2d 1121, 1123 (5th Cir. 1988)

(*per curiam*). Moreover, the Court of Appeals has also held that a district court may inquire into the reliability and foundation of any expert's opinion to determine its admissibility. Soden v. Freightliner Corp., 714 F.2d 498, 502 (5th Cir. 1983).

Application of these principles by the Fifth Circuit to summary judgment proceedings in jury actions has thus lead to decisions such as Viterbo v. Dow Chemical Co., 826 F.2d 420 (5th Cir. 1987), wherein the district court granted a motion for summary judgment and concluded that the testimony of the non-movant's expert, a medical doctor, was inadmissible under Federal Rules of Evidence 703 and 403. Following prior decisions, the Court of Appeals reaffirmed the rule that the trial court's ruling on the admissibility of expert testimony must be sustained unless manifestly erroneous, and specifically noted that the

dispute did not concern the qualifications of the expert but rather the source and basis of the expert opinion he tendered. Viterbo, *Id.*, at 422. Following a review of the report at issue, the Court of Appeals in Viterbo, *supra*, affirmed the trial court's assessment that the report lacked the foundation and reliability necessary to support expert testimony, and concluded that "[W]ithout more than credentials and a subjective opinion, an expert's opinion that 'it is so' is not admissible. *Id.*, at 424.

The decisions of the Fifth Circuit thus provide that the trial courts have broad discretion in ruling on the admissibility of expert testimony, and that in jury actions such as Viterbo, *supra*, a trial court's decision to refuse to admit expert testimony will be reviewed under the "manifestly erroneous" standard. This analysis includes the rule that evidence admissible under

Federal Rule of Evidence 703 must satisfy Federal Rule of Evidence 403, which provides for the exclusion of evidence "if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury." Barrel of Fun, Inc. v. State Farm Fire & Casualty Co., 739 F.2d 1028, 1035 (5th Cir. 1984).

However, while this standard permits wide discretion to the trial courts with respect to admissibility issues in jury actions, the Fifth Circuit has also held that application of Federal Rule of Evidence 403 to exclude evidence based upon a weighing of probative value against prejudice is reversible error in a bench trial. Gulf States Utilities Company v. Ecodyne Corporation, 635 F.2d 517 (5th Cir. 1981). In Gulf States, *supra*, the trial judge refused to admit certain evidence as

inadmissible under Rule 403. The trial court reasoned that the evidence would be prejudicial to a jury, and since the court would therefore not let a jury hear the evidence, a judge in a bench trial should not hear it either. Gulf States, 635 F.2d at 517. In its opinion reversing the district court, the Court of Appeals for the Fifth Circuit stated the following:

> The exclusion of this evidence under Rule 403's weighing of probative value against prejudice was improper. This portion of Rule 403 has no logical application to bench trials. Excluding relevant evidence in a bench trial because it is cumulative or a waste of time is clearly a proper exercise of the judge's power, but excluding relevant evidence on the basis of "unfair prejudice" is a useless procedure. Rule 403 assumes a trial judge is able to discern and weigh the improper inferences that a jury might draw from certain evidence, and then balance those improprieties against probative value and necessity. Certainly, in a bench trial, the same judge can also exclude those improper inferences from his mind in reaching a decision. The significant question is whether the

> trial judge's action here produces an error or defect that affected substantial rights of Gulf States. 28 U.S.C. §2111; Fed.R.Civ.P. 61. The judge heard the offer of proof but said he would not consider this evidence in making his factual determinations. We have no choice but to believe him. He is trained to recognize and exclude those matters which the rules of evidence require be discarded. Indeed, in this very case the trial judge acknowledged the possibility that this court might disagree with his ruling and direct him to consider this evidence. That possibility has now materialized. The major policy underlying the harmless error rule is to preserve judgments and avoid waste of time. Discarding a jury verdict is extremely wasteful. Requiring a district judge to examine more evidence and reevaluate his decision is not nearly so prodigal. (Footnotes omitted.)

Id., at p. 519, 520.

The Court of Appeals erred in failing to recognize the district court's discretion in dealing with expert testimony, and in conducting a *de novo* review of the district court's appraisal of the expert evidence. The court failed to apply a "manifestly

erroneous" standard. This cannot be reconciled with the Fifth Circuit's own decisions and those of this Court.

As in Viterbo, *supra*, the district court in this case did not refuse to accept the government's witness as an expert, but rather found upon examination that the evidence proffered by that witness failed to provide any basis upon which the trial court could find for the government on the issue of valuation. Unlike Viterbo, *supra*, however, the trial court in this case did not exclude the evidence provided by the expert testimony. Rather, the district court in this bench trial followed the appellate court's decision in Gulf States, *supra*, and admitted the evidence notwithstanding the fact (clearly expressed by the district judge in the course of his decision) that it provided no basis or foundation upon which

the court could find for the government on the issue of valuation.

Comparison of the Fifth Circuit's approach in jury and non-jury actions plainly reveals an anomaly which violates the summary judgment principles set forth by this Court and the Fifth Circuit as well. Had this been a jury action, the trial court's express finding that the government's expert report failed to provide a basis for a finding of overvaluation would have clearly formed a predicate for the court to refuse to admit the report under Federal Rules of Evidence 403 or 703. Moreover, the decisions in the Fifth Circuit specifically provide that in reviewing such an action the appellate court would recognize the trial court's broad discretion in this area and the district court's finding would be sustained unless manifestly erroneous. See, Viterbo v. Dow

Chemical Co.; Rodriguez v. Olin Corp.; Crawford v. Worth; *supra*.

In this case, however, the trial court accepted the government's witness as an expert and received the expert report into evidence, notwithstanding express findings on the report's lack of foundation upon which the court felt it could make a determination on the issue of valuation. The action of the trial court in receiving and considering the evidence thus complied with the Fifth Circuit's decision in Gulf States, *supra*, and simultaneously followed this Court's direction that in ruling on a motion for summary judgment "[T]he evidence of the non-movant is to be believed, and all justifiable inferences are to be drawn in his favor." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 255 (1986); Citing, Adickes v. S.H. Kress & Co., 398 U.S. 144, 158-159 (1970). In its review on appeal, however, the Court

of Appeals failed to recognize or even address the issues of the scope of discretion to be afforded the trial court or the standard of review to be applied, and simply conducted a *de novo* review of the decision.

Certiorari must be granted in this case to review the denial of taxpayers' right to have their case considered by the Court of Appeals under the correct (manifest error) standard of review. Where a district court has expressly reviewed expert testimony and determined a motion for summary judgment in a manner plainly in accordance with this Court's decisions, the fact that the case is to be tried before the court cannot provide any legitimate basis for altering the standard of review to be applied by the Court of Appeals. If a district court is provided broad discretion to rule on the admissibility of expert testimony in jury actions, and if those decisions are not to be disturbed

unless manifestly erroneous, it is simply untenable that the trial judge could, *de facto*, reach the same conclusion as to the evidentiary value of expert testimony in a bench trial but not be afforded the same latitude with respect to the exercise of his discretion as is provided in a jury action.

CONCLUSION

This case presents an appropriate issue upon which the Court should grant certiorari. Review of this action by the Court will serve to provide necessary instruction to the Courts of Appeals and the district courts as to the range of district court discretion and the standard of appellate review in non-jury actions where expert testimony is the linchpin of summary

judgment motions. Accordingly, the petition for writ of certiorari should be granted.

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April 5, 1990

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SAMUEL I. SHUMAN, *et al.*	)	C.A. H-85-1672
	)	
vs.	)	
	)	HOUSTON, TEXAS
UNITED STATES OF AMERICA	)	SEPTEMBER 6, 1988

TRANSCRIPT OF HEARING
BEFORE THE HONORABLE LYNN N. HUGHES

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Proceedings recorded by mechanical stenography. Transcript produced by computer aided transcription.

P R O C E E D I N G S

THE COURT: THANK YOU. BE SEATED. ALL RIGHT. TELL ME ABOUT THE PROBLEMS THAT THE PLAINTIFFS ARE HAVING WITH THE GOVERNMENT'S EXPERT. APPARENTLY, THERE'S SOME PROBLEM. SOME QUALIFICATION OR SOMETHING?

MR. GROSSMAN: YOUR HONOR. WE REALLY HAVE NOT BEEN TO THE STATUS, I DON'T THINK YET, OF DEPOSING EXPERTS. IN OUR MOTION FOR SUMMARY JUDGMENT --

THE COURT: I THOUGHT YOU BOTH HAD EVALUATIONS FROM EXPERTS?

MR. GROSSMAN: YES, YOUR HONOR. IN OUR MOTION FOR SUMMARY JUDGMENT, WE HAVE A PROBLEM WITH THE EXPERT IN TERMS OF WHAT HE HAS DONE. THE GOVERNMENT RELIES ON MR.

ALLESCO'S -- I HOPE I PRONOUNCE THAT CORRECTLY -- OPINION FOR THE PROPOSITION THAT THE ART MASTER PLATE BUSINESS IS NOT A VIABLE BUSINESS, IN HIS VIEW.

SINCE THE PLAINTIFF SOLD ART MASTER PLATES AND NOT AN ART MASTER PLATE BUSINESS, AND IN MR. ALLESCO'S OWN WORDS, HE COULD NOT ASCRIBE A VALUE TO THE PLATES, IT IS OUR VIEW THAT SINCE HE COULD NOT DO WHAT HE WAS EMPLOYED TO DO, HIS APPRAISAL, AS A MATTER OF LAW, IS IRRELEVANT AND INEFFICACIOUS FOR THIS CASE AND THAT THE PLAINTIFF MUST WIN, AS A MATTER OF LAW.

THE COURT: HAVE YOU DEPOSED HIM?

MR. GROSSMAN: WE'VE NOT DONE ANYTHING, YOUR HONOR, BECAUSE I BELIEVE THE COURT WANTED TO SUSPENSE ALL OF THE ACTIVITY IN THIS CASE, INCLUDING DEPOSITIONS, BY ITS ORDER, DEPENDENT UPON OUR MOTION FOR SUMMARY JUDGMENT AND OUR SUPPLEMENT TO THE MOTION FOR SUMMARY JUDGMENT BASED ON THE HOUSTON CASE,

WHICH IS WHAT I THOUGHT WAS THE PRIMARY THRUST OF TODAY'S ARGUMENT.

THE COURT: I BELIEVE IT IS. I'M JUST -- HOW CAN I CONCLUDE FROM YOUR EXPERT THAT THESE THINGS ARE 200 PERCENT OF THEIR VALUE?

MR. BRACKEN: YOUR HONOR, I BELIEVE OUR EXPERT OPINION INDICATES THAT NEITHER THE PLATES HAD ANY PARTICULAR INTRINSIC VALUE, NOR THE LONG-TERM OUTCOME, AS A RESULT OF UTILIZING THOSE PLATES, HAD ANY MEANINGFUL INCOME.

I BELIEVE THAT HE INDICATES IN HIS REPORT, AND IT'S BACKED UP AGAIN WITH HIS AFFIDAVIT THAT WAS FILED WITH THE MEMORANDA BY OUR ATTORNEY, B. J. KELLEY, THAT INDICATES THAT HE DID NOT ASCRIBE ANY VALUE. IT WAS NOT THAT HE HAD NO ABILITY TO ASCRIBE A PARTICULAR VALUE TO IT. HE DETERMINED, IN HIS OPINION, THAT THE VALUE WAS MINIMAL, AT BEST.

MR. GROSSMAN: YOUR HONOR, IF I MAY, ON THAT POINT I'D LIKE TO READ VERBATIM FROM THE RECORD FROM MR. ALLESCO'S REPORT, AND I READ VERBATIM, IT'S CONTAINED ON PAGE 6 OF OUR ORIGINAL MOTION.

QUOTE: YOU HAVE REQUESTED, SAYS MR. ALASKO, THAT I PREPARE A PROFESSIONAL OPINION OF THE FAIR MARKET VALUE OF THE MASTERS, QUOTE-UNQUOTE, USED IN THE PREPARATION OF THESE ART WORKS.

QUOTE: NO VALUE CAN BE ESTIMATED FOR THE MASTERS OR MASTER PLATES SINCE SUCH ESTIMATES, HYPHEN, AS THEY RELATE TO THE ENTERPRISE, HYPHEN, WOULD BE SPECULATIVE. THE VALUE OF THE RIGHTS IMPLIED BY THE TERMS MASTER OR MASTER PLATES WOULD BE THE NET INCOME FROM THE SALE OF THE PRINTS PRODUCED AFTER THE RECAPTURE OF ALL EXPENSES OTHER THAN THE PRICE OF THE RIGHTS. ONLY TO THE EXTENT THAT THERE IS AN INCOME DO THE RIGHTS HAVE VALUE.

IT SEEMS TO ME WHAT MR. ALASKO, WHO IS APPARENTLY AN ART APPRAISER, DID WAS REVIEW THE BUSINESS PROSPECTS OF A PRODUCTION COMPANY FOR THESE PLATES SINCE WHAT WAS SOLD WERE THE PLATES THEMSELVES AND NOT A BUSINESS, AND MR. ALASKO --

THE COURT: I UNDERSTAND YOUR ARGUMENT. IT LOOKS TO ME LIKE THAT GOES TO THE WEIGHT AND YOUR ARGUMENT IS THAT THERE IS NO WEIGHT TO THE EVIDENCE AS OPPOSED TO BALANCING IT WITH YOUR EVIDENCE AND SAYING THAT THERE IS A PREPONDERANCE ON YOUR SIDE. AS A MATTER OF LAW, THAT AMOUNTS TO LESS THAN A SCINTILLA.

MR. GROSSMAN: BECAUSE OF THE, QUOTE, SECTION 6703 REQUIRING THE BURDEN OF PROOF TO BE SHOULDERED BY THE GOVERNMENT IN THESE CASES, WHERE AN EXPERT SAYS HE CANNOT ESTIMATE A VALUE ON AN ITEM, HE FAILS TO DO THAT WHICH HE WAS SPECIFICALLY EMPLOYED TO DO.

THE COURT: BUT YOUR ARGUMENT IS THAT, AS A MATTER OF LAW, IT IS INSUFFICIENT TO RAISE A FACT QUESTION, NOT THAT YOUR WEIGHT IS OVERWHELMINGLY THE OTHER WAY, BECAUSE THAT IS A FACTUAL THING.

MR. GROSSMAN: WE BELIEVE, AS A MATTER OF LAW, WHEN AN EXPERT'S EMPLOYED TO DO A JOB AND HE SAYS "I CANNOT DO IT," WHERE THE BURDEN OF PROOF IS ON THE GOVERNMENT, IT MUST FAIL AS A MATTER OF LAW.

MR. BRACKEN: FIRST OF ALL, I DON'T BELIEVE THAT THE GOVERNMENT'S EXPERT HAS FAILED TO RENDER AN OPINION IN THIS PARTICULAR CASE. I DO BELIEVE THAT HE DID, IN FACT, RENDER AN OPINION. THE OPINION HE RENDERED WAS THAT THE PLATES AND ANY INTRINSIC VALUE, WHICH HAS TO GO ALONG WITH THIS, HAD, AT BEST, A MINIMAL VALUE.

THE COURT: OF COURSE, HIS OPINION IS WHATEVER HE EXACTLY SAID.

MR. BRACKEN: YES, YOUR HONOR.

THE COURT: AND IT SEEMS TO BE THE QUESTION THAT I HAVE TO FACE THIS AFTERNOON IS WHETHER THAT OPINION RAISES -- HE HAS SUFFICIENT WEIGHT TO RAISE A FACTUAL ISSUE, BECAUSE IF I SAY THAT IT DOES NOT AMOUNT TO A PREPONDERANCE OF THE EVIDENCE ON VALUE, THEN THAT'S A FINDING OF FACT WHICH SHOULD NOT BE DONE IN A SUMMARY JUDGMENT HEARING.

SO THAT IT SEEMS TO ME THE CORRECT POSTURE IS, IS THIS AFFIDAVIT SOME EVIDENCE OF VALUE THAT WOULD SUPPORT A FINDING?

MR. BRACKEN: YOUR HONOR, PERHAPS I MIGHT BE ABLE TO HELP YOU A LITTLE BIT. THERE IS AN AFFIDAVIT THAT IS ATTACHED TO THE MEMORANDA THAT WAS FILED BY MR. KELLY THE 6TH OF NOVEMBER IN HIS CROSS-MOTION. AND ON PAGE 2 OF MR. ALLESKO'S EXHIBIT A, ON PAGE 2 MR. ALASKO STATES UNDER OATH THAT IF HE CONVEYED THE IMPRESSION THAT HE COULDN'T VALUE, THAT WAS A MISTAKE ON HIS PART.

BUT, IN ANY EVENT, HE DID INTEND TO CONVEY THAT THEY HAD NO VALUE. HE STATES THAT, ITEM NUMBER 6, IT IS MY PROFESSIONAL OPINION THAT THE TERM, MASTER PLATES, IS ITSELF MISLEADING AND IS ATYPICAL TO THE LEGITIMATE ART PRINTS INDUSTRY. NOTWITHSTANDING THIS FACT, IT IS MY PROFESSIONAL CONCLUSION THAT WITHOUT CAVEAT, THE MASTER PLATES REFERRED TO IN THIS PRIVATE OFFERING MEMORANDA AND PURCHASE AGREEMENT WITH TEXANNA ART TRADING COMPANY FOR 1982 HAVE NO VALUE.

MR. GROSSMAN: YOUR HONOR, IF WE MAY BE HEARD ON THAT POINT. THE ONLY REASON THAT AFFIDAVIT WAS SUPPLIED WAS IN RESPONSE TO OUR MOTION FOR SUMMARY JUDGMENT. I DON'T BELIEVE THE COURT CAN CONSIDER, AS A MATTER OF LAW, AN EXPERT WHO, ON THE ONE HAND, STATES NO VALUE CAN BE ESTIMATED, AND ON THE SECOND HAND STATES, THE VALUE IS ZERO.

IF, INDEED, AS HE WAS EMPLOYED TO DO, A REPORT WAS MADE WHERE NO VALUE CAN BE ESTIMATED FOR THE MASTERS, QUOTE-UNQUOTE, THEN IT IS IMPOSSIBLE, PER FORCE, FOR A VALUE OF ANY ODD ITEM OR AMOUNT TO BE SUPPLIED BY THE EXPERT. IT WOULD BE INCONSISTENT FOR THE COURT TO ACCEPT BOTH STATEMENTS; I.E., NO VALUE CAN BE ESTIMATED FOR THE MASTER OR MASTER PLATES, BUT THE VALUE IS ZERO. IF THE VALUE IS ZERO, A VALUE COULD BE ESTIMATED.

BUT SINCE IT CAN'T BE ESTIMATED BY THIS APPRAISER, AN ELEVENTH HOUR ATTEMPT AFTER OUR MOTION FOR SUMMARY JUDGMENT HAS BEEN FILED TO ANSWER THAT, IT SEEMS AS BOTH SELF-CONTRADICTORY AND FATUOUS ON ITS FACE.

MR. BRACKEN: I SEE ONLY A CLARIFICATION OF MISCONCEPTION ON THE PART OF PLAINTIFFS' COUNSEL.

MR. GROSSMAN: ALL THE PLAINTIFF CAN DO IS READ THE WORDS, YOUR HONOR, WHERE THE WORDS SAY, NO VALUE CAN BE ESTIMATED FOR THE

MASTERS. UNLESS A READING HAS TO BE ADAPTED WITH JUDICIAL GLOSS, THE WORDS MUST MEAN WHAT THEY SAY. WE TOOK IT SERIOUSLY. THIS IS AN EXTREMELY DIFFICULT AND EXPENSIVE CASE FOR THE PLAINTIFFS TO FIGHT. WHERE NO VALUE CAN BE ESTIMATED, IT SEEMS TO ME, THAT THE APPRAISER CANNOT BE IN A POSITION TO LATER SAY, WELL, THE VALUE IS A HUNDRED DOLLARS A PLATE OR ZERO A PLATE. HE MUST STICK WITH WHAT HE GAVE THE COURT IN HIS ORIGINAL APPRAISAL AS HIS APPRAISAL.

THE COURT: WELL, I'M NOT CONVINCED THAT THE ADENDUM DOES THE PLAINTIFFS ANY HARM. FRANKLY, I FIND VERY LITTLE OF EVIDENTIARY WEIGHT IN THE ADDENDUM. HE HAS A CONCLUSION THAT THERE'S INSUFFICIENT DEMAND FOR -- SINCE EVERYBODY ELSE IS QUOTING, I MIGHT AS WELL QUOTE, TOO -- LIMITED EDITION PRINTS, POSTERS, GREETING CARDS, MURALS AND TAPESTRIES, REPRODUCED FROM IMAGES AS THOSE INVOLVED IN THIS CASE.

THAT DOESN'T HAVE ANY PERSUASIVE WEIGHT AS A FACTUAL RECITATION. THERE'S A HUGE MARKET FOR POSTERS AND GREETING CARDS AND THINGS. NOW, IF HE'S SAYING THAT, AS A MATTER OF TASTE, THERE'S NO MARKET FOR THESE THINGS -- THAT IS, THE IMAGES THEMSELVES ARE INARTISTIC, OR WHATEVER, THAT'S SOMETHING, OF COURSE, THAT IS DIFFICULT TO ACCEPT SINCE I FIND THAT THINGS I CONSIDER TASTELESS TO BE MAKING MONEY HAND OVER FIST ALL OF THE TIME.

MR. BRACKEN: I THINK HE ALSO, YOUR HONOR, LOOKS AT THE QUANTITY THAT WOULD BE REQUIRED IN NOTING THAT THE SUPPLY OUTSTRIPS THAT DEMAND.

MR. GROSSMAN: YOUR HONOR, EVEN --

THE COURT: BUT THE SUPPLY OF WHAT OUTSTRIPS THE DEMAND?

MR. BRACKEN: HE'S LOOKING AT ALL THE ITEMS THAT ARE TO BE ULTIMATELY SOLD FROM THIS. THAT'S APPARENT WHAT THE INDIVIDUALS, THE PLAINTIFFS IN THIS PARTICULAR CASE, WERE

SELLING TO THESE INVESTORS. AND THAT'S THE MANNER IN WHICH THEY ARE ORIGINALLY VALUED BY THE PLAINTIFFS IN THIS CASE.

THE COURT: IT SEEMS TO ME THAT MR. ALASKO HAS GOT TO IDENTIFY THE MARKET THAT THESE THINGS WOULD BE RELEVANT TO. I MEAN, HE CAN'T TELL ME THAT IF YOU SUPERIMPOSE MADONNA AND MAYBE A COUPLE OF SWASTIKAS, A LIGHTNING BOLT ON ANY OF THESE IMAGES, THAT IT WOULDN'T SELL A MILLION COPIES, BECAUSE APPARENTLY THERE IS A HUGE MARKET FOR THAT GARBAGE, IRRESPECTIVE OF ANY ARTISTIC MERIT THAT YOU AND I MIGHT LIKE TO BELIEVE THAT ARE IN THERE.

IT WAS THAT FAMOUS ART CRITIC, H. L. MENCKEN, WHO SAID YOU'LL NEVER GO BROKE UNDERESTIMATING THE TASTE OF THE AMERICAN PEOPLE. BUT HE DOESN'T -- I MEAN, I DON'T KNOW ABOUT TAPESTRIES, I CONFESS. I DIDN'T KNOW PEOPLE STILL DID THAT, FOR SURE, BUT WE

HAVE A BARE CONCLUSION THAT THERE'S NO DEMAND OUT THERE FOR THIS SORT OF THING.

MR. BRACKEN: NOT REALLY, YOUR HONOR. IN HIS EARLIER OPINION THAT'S BEEN REFERRED TO HERE, HE STARTS OUT BASICALLY WITH A HISTORY OF THE ART PRINT INDUSTRY AND HE TRACES THAT HISTORY DOWN TO THE PERIOD OF TIME IN QUESTION, 1981, 1982. HE ALSO DOES A BRIEF ECONOMIC REVIEW OF THE ART PRINT INDUSTRY AT THAT POINT IN TIME.

HE STATES ON PAGE 3 OF HIS OPINION THAT THE PRINTS EXAMINED FOR THIS REPORT ARE PROPERTIES REFERRED TO DIRECTLY OR INDIRECTLY IN BUSINESS AGREEMENTS MADE IN 1982 AT THE TIME THAT THE ART MARKET IN GENERAL WAS SLUGGISH AND THE MARKET IN PRINTS BY CONTEMPORANEOUS ARTISTS WAS PRACTICALLY MORIBUND. HE DIDN'T LOOK AT THIS IN A VACUUM. HE DID LOOK AT IT AT THE POINT IN TIME WHEN THE SALES HAD TO HAVE OCCURRED TO JUSTIFY THE VALUES THAT WERE IN QUESTION.

THE COURT: SALES DIDN'T HAVE TO OCCUR IN OCTOBER OF '82.

MR. BRACKEN: NO, BUT HE DOES NOTE --

THE COURT: THE POTENTIAL HAD TO BE THERE.

MR. BRACKEN: YES, SIR. BUT THAT'S THE POINT IN TIME WHEN THESE WERE VALUED TO THE INDIVIDUAL INVESTORS. AND IF THE CURRENT MARKET DIDN'T HAVE THAT, THERE WASN'T ANY INDICATION THAT A FUTURE MARKET COULD POSSIBLY SUPPORT THAT.

THE COURT: I JUST REREAD THE ORIGINAL APPRAISAL, TOGETHER WITH THE SECOND ONE, AND I CAN TAKE ALL OF HIS BACKGROUND THINGS AS TRUE IN THERE, BUT HOW MANY OF THESE PRINTS HAS TO BE SOLD FOR $300 IN ORDER TO RECOVER THE INVESTMENT?

I MEAN, HE TALKS ABOUT THE MARKET FOR THESE THINGS, AND I THINK HE CONFUSES THE FINE ART FROM THE ROUTINE ART MARKET WHEN HE TALKS ABOUT THE MARKET FOR SOME PARTICULAR

PERSON TO HAVE DISAPPEARED. BUT THAT WASN'T PRINT -- THE MARKET FOR ALL POSTERS AND PRINTS AND GREETING CARDS. IT WAS A MARKET FOR HENRI RIVIERE. I MEAN, HENRI CAME AND WENT IN A SEVEN-MONTH PERIOD, BUT POSTERS WERE STILL BEING DONE.

THEY HAVE TO MARKET 500 PRINTS AT $300 A PRINT.

MR. GROSSMAN: BUT, YOUR HONOR, THERE ARE OTHER WAYS TO --

THE COURT: I UNDERSTAND, BUT EVEN THOUGH THEY TALK ABOUT THE THREE TO $5,000 RANGE, AND DROPPING TO THE $300 RANGE, PEOPLE WHO ARE BUYING $5,000 PRINTS ARE BUYING FINE ART, OR THINK THEY'RE BUYING FINE ART. FINE ART MAY END UP ON GREETING CARDS, BUT THE $8,000 FOR COLOR SEPARATIONS MAY BE NECESSARY FOR HENRI'S POSTERS, BUT FOR YOUR RUN-OF-THE-MILL GREETING CARD, THAT MAY NOT BE WHAT THEY COST.

AND NONE OF THAT'S IN THERE. I DON'T KNOW WHAT MARKET NICHE THESE THINGS BELONG TO. AND I'LL ASSUME THAT THEY HAVE SOME ARTISTIC MERITS SINCE I'M GOING TO DECIDE THAT. I WOULDN'T LET THE MARKET DECIDE THAT.

I DON'T SEE HOW I CAN CONCLUDE FROM WHAT HE SAID THAT THESE PARTICULAR PLATES, MASTERS, NONE OF THE TERMINOLOGY WHICH HE LIKES, BUT I'M NOT SURE THAT AFFECTS THE VALUE -- THEY'D HAVE TO SELL - WHAT? 3,000 OR 30,000? FOR FIVE DOLLARS NET PROFIT? 30,000.

MR. BRACKEN: I'M SORRY, SOLD WHAT?

THE COURT: THEY'D HAVE TO SELL 30,000 POSTERS IF THEY WERE PROFITING FIVE BUCKS A POSTER --

MR. BRACKEN: YES.

THE COURT: -- TO MAKE A PROFIT TO RECOVER THE INVESTMENT.

MR. BRACKEN: THERE'S ALSO A QUESTION OF THE ADDITIONAL RIGHTS THAT MAY BE DUE TO THE SELLERS OF THESE MASTER PLATES, OR WHATEVER, AS A RESULT OF THE AGREEMENTS THAT WERE DRAWN UP. SO IT'S NOT STRICTLY YOU GET PROFITS FOR EVERY ITEM YOU SELL OF FIVE DOLLARS.

IN ADDITION TO WHATEVER COSTS OF SUPPLIES AND PRINTING COSTS AND ADDITIONAL COSTS THAT WOULD ENTER INTO THE NET INCOME THAT WOULD HAVE ULTIMATELY BEEN DERIVED.

THE COURT: I UNDERSTAND, BUT HE DOESN'T EXPLAIN IF YOUR MARKET IS GREETING CARDS, HOW MANY GREETING CARDS OF WHAT PRICE AND SIZE YOU HAVE TO SELL; THAT THE ONLY WAY YOU CAN DO IT IS BY GETTING INTO THE HALLMARK MARKET OR THE AIRPORT CONCESSION MARKET.

HE QUOTES A BUNCH OF STUFF IN SOME HIGH-TONE ART MAGAZINE ABOUT A LEVEL OF PRINTS, WHICH I DON'T THINK WE'RE TALKING ABOUT.

MR. BRACKEN: WELL, THERE WERE SOME PRINTS I THINK THAT WERE CALLED LIMITED EDITION PRINTS THAT WERE INITIALLY TO BE DIVIDED UP AND SOME OF WHICH WENT TO THE INVESTORS WHO WERE ULTIMATELY SOLD. I THINK THAT'S HOW HE GOT OFF INTO THAT AREA, BECAUSE THEY WERE SUPPOSED TO BE SIGNED, NUMBERED, LIMITED EDITION-TYPE OF PRINTS THAT WERE SUPPOSED TO HAVE BEEN MADE FROM THESE PLATES.

THE COURT: BUT THE ONLY REASON YOU SELL LIMITED EDITION PRINTS IS YOU THINK THAT MAXIMIZES YOUR PROFIT.

MR. BRACKEN: ABSOLUTELY.

THE COURT: YOU DO A MASS RUN AT THE SAME PLACE THAT THE PITTSBURGH STEELERS USE IF YOU THINK THAT MAXIMIZES YOUR PROFIT.

MR. BRACKEN: I THINK THE ASSUMPTION HERE IS THAT, AT LEAST IN THE ESTIMATES THAT WERE GIVEN TO THE INVESTORS, WERE THAT THEY COULD SELL -- OR THAT THEY COULD PRODUCE SO MANY LIMITED EDITION, SO MANY SPECIAL EDITION

THAT WERE SOLD AT DIFFERING PRICES OR TO BE SOLD AT DIFFERING PRICES, AND THEN DOWN FROM THAT YOU GOT OTHER ITEMS, THE MISCELLANEOUS POSTERS AND POST CARDS, ET CETERA, THAT WERE OBVIOUSLY TO BE SOLD AT A SUBSTANTIALLY LOWER VALUE.

THE COURT: BUT YOUR MAN DOESN'T SAY THAT'S NOT TRUE. HE DOESN'T ADDRESS POST CARDS, NOTE CARDS, MOTEL ART. YOU KNOW, I DON'T KNOW WHAT THE MARKET FOR ALL THIS STUFF IS.

BUT WE'RE NOT TALKING ABOUT REMBRANDT ETCHINGS HERE. WE'RE TALKING ABOUT A MORE PEDESTRIAN LEVEL OF ARTISTIC ENTERPRISE.

BUT I WOULD RATHER HAVE, FOR FINANCIAL PURPOSES, A COPYRIGHT ON COCA COLA THAN A COUPLE OF REMBRANDTS.

IF THIS CASE WERE TRIED, WHAT WOULD YOU HAVE TO OFFER BEYOND THAT?

MR. BRACKEN: I'M SORRY?

THE COURT: WHAT WOULD YOU HAVE TO OFFER BEYOND THIS EXPERT'S EVALUATION?

MR. BRACKEN: I SUSPECT THAT WE PROBABLY HAVE TO DO AN ANALYSIS OF THE DIFFERENT OFFERINGS THAT WERE TO BE MADE AND TRY AND HAVE SOME DETERMINATION THAT -- IF HE HASN'T ALREADY DONE SO -- HAVE A DETERMINATION MADE AS TO WHAT THE MARKET IN THOSE SPECIFIC ITEMS WOULD HAVE BEEN IN THE PARTICULAR AREA OF DISTRIBUTION, STARTING WITH THESE SPECIAL EDITIONS OR LIMITED EDITIONS, HOW MANY OF THOSE YOU'D SELL.

IT WOULD BE SIMILAR TO WHAT THE TAX COURT VIEWED IN THE ROSE CASE THAT WAS ATTACHED. THERE EXPERT REVIEWED THE DIFFERENT TYPES OF OFFERINGS AND DETERMINED THAT YOU HAD TO OFFER A SUBSTANTIAL QUANTITY OF -- AS THE NUMBER ACTUALLY SOLD OR TO BE SOLD IN THE ENTIRE DOLLAR QUANTITIES WAS REDUCED, YOU HAVE TO OBVIOUSLY GENERATE A HIGHER SALES VOLUME IN THE LOWER ECHELONS TO

SUBSTANTIATE THE PRICE THAT WAS ACTUALLY PAID.

THE COURT: BUT YOUR MARGIN MIGHT BE HIGHER AS A PERCENTAGE OF THE SALES PRICE IN THE LOWER UNIT ITEMS. I ASSUMED IF YOU SELL A HIGH-QUALITY ART PRINT IN AN ART GALLERY THERE IS A HUGE DISCOUNT JUST TO THE RETAILER. BUT IF YOU SELL MASS, ORDINARY PRINTS THROUGH WHATEVER FIVE AND DIME STORES ARE CALLED TODAY, YOUR DISCOUNT FROM THE RETAIL MAY BE A LOT MORE MODEST THAN IT IS THROUGH A GALLERY.

MR. BRACKEN: IT KNOW THAT THE MARK-UP TYPICALLY IN A GROCERY STORE OR SOMETHING LIKE A CONVENIENCE-TYPE OF STORE, OR MAYBE EVEN A K-MART OR THINGS LIKE THAT, IS TYPICALLY THREE QUARTERS OF ONE PERCENT. SO THEIR MARGIN IS PRETTY SMALL.

I SUSPECT THAT THE ULTIMATE --

THE COURT: BUT THAT'S THEIR MARGIN OVER GROSS. THAT'S NOT THEIR MARGIN ON THE COST OF GOODS.

MR. BRACKEN: YES, SIR. ABSOLUTELY, BUT IT'S COMPOSED OF A WHOLE LOT OF ITEMS THAT MAKE THAT UP. I SUSPECT THAT THE PRODUCERS MARGIN IS NOT SUBSTANTIALLY GREATER BECAUSE THERE IS A PRETTY FAIR COMPETITION IN THE MARKETPLACE FOR THOSE TYPE OF ITEMS, SO THAT THE MARGIN TO THE ULTIMATE PUBLISHER, PROBABLY -- AND I'M SPECULATING; I DON'T KNOW -- BUT IS PROBABLY NOT AS WIDE AS YOU MIGHT THINK.

THE COURT: NO, BUT I SUSPECT THAT IN AN ART GALLERY, THEY PROBABLY TRIPLE THEIR COSTS TO GET TO THE RETAIL OF A FINE ART PIECE. THEY'RE LOW VOLUME, HIGH OVERHEAD OPERATIONS.

BUT PUTTING A POSTER IN EVERY CIRCLE GALLERY IN THE CHAIN, OR PUTTING A POSTER IN EVERY DEPARTMENT STORE THAT

FEDERATED HAS, IS NOT GOING TO REQUIRE THE SAME MARK-UP.

IS THERE ANY OTHER EVIDENCE THAT PLAINTIFFS WOULD HAVE TO OFFER AT TRIAL?

MR. GROSSMAN: WELL, OUR UNDERSTANDING WAS, YOUR HONOR, THAT THE DEFENDANT HAS THE BURDEN OF PROOF AND THAT -- WEDNESDAY TWO CONFERENCE CALLS WITH THE COURT AND THE COURT INSTRUCTED THE DEFENDANT TO PREPARE HIS EXPERT REPORT, AND THEN FOR US TO MAKE APPROPRIATE MOTIONS.

WE WOULD, OF COURSE, GIVE AN APPRAISAL TO THE COURT IF WE FELT THAT THERE WAS SOME ISSUE OF FACT OR WE HAD TO DEFEND OUR POSITION WITH AN APPRAISAL.

WHAT WE WE HERE IS THE LACK OF AN APPRAISAL OR AN APPRAISAL ON SOMETHING WHICH IS NOT WHAT THE COURT HAS ASKED FOR, AND WE WOULD SUPPLY AN APPRAISAL TO THE COURT IF WE HAD TO.

BUT AT THIS POINT IT SEEMS TO ME THAT UNDER THE COURT'S CONFERENCE PHONE CALL RULINGS, THAT WE'RE NOT IN THAT POSITION. THE GOVERNMENT HAS FAILED TO DO WHICH IT CONCLUDED THAT IT MUST DO ON THE PHONE. THE APPRAISAL IS INHERENTLY DEFECTIVE AND THE TIME IS NOW RIPE FOR A GRANTING OF OUR MOTION FOR JUDGMENT.

SO, IN OTHER WORDS, WE COULD NOT PREPARE A RESPONSE TO THE VALUE OF THESE PLATES SINCE THERE'S NEVER BEEN IN EVIDENCE, IN OUR VIEW, ANY JUDGMENT AS TO THE VALUE OF THE PLATES. AND WITHOUT A -- THE GOVERNMENT SETTING FORTH WHAT IT HAD TO, WE CAN'T RESPOND TO IT. PLATES WERE SIMPLY NOT VALUED. SINCE THE GOVERNMENT DID NOT VALUE WHAT IT MUST, IT COULDN'T SHOW THAT THERE WAS MORE THAN TWO HUNDRED PERCENT OF THE STATED VALUE WAS IN EXCESS. THEREFORE, THE PLAINTIFFS MUST WIN AS A MATTER OF LAW.

THE COURT: OKAY. ANYTHING ELSE FROM THE GOVERNMENT?

MR. BRACKEN: NO, YOUR HONOR. I'VE SAID IT ALL.

THE COURT: ALL RIGHT. JUDGMENT WILL BE GRANTED FOR THE PLAINTIFFS. I JUST DON'T THINK, AT THIS STAGE, AND I KNOW I, BACK SOME TIME LAST YEAR, APPARENTLY SAID LET'S DISPOSE OF TWO THRESHOLD ISSUES BY MOTION BEFORE WE DID ANYTHING FURTHER, BUT, I MEAN, WE'RE THREE YEARS INTO THIS LITIGATION AND IT'S TIME FOR A RIGOROUS EVALUATION OF THE POSITION THAT THE GOVERNMENT HAD.

AND, FRANKLY, I FIND THE EVALUATION TO BE NO EVIDENCE OF THE PARTICULAR ENTERPRISE ENTERED INTO BY THE PLAINTIFFS. IT CERTAINLY IS A NICE DISCUSSION OF THE UPPER END OF THE PRINT MARKET, BUT HIM JUST SAYING THAT THE COST OF PRODUCTION SHOULD BE EXCESSIVE DOESN'T GIVE ME ANYTHING TO GO ON IN FIGURING AND

EVALUATING HIS POSITION, MUCH LESS EVALUATING WHETHER IT IS MORE THAN 200 TIMES.

MR. BRACKEN: I THINK WHAT HE SAYS, THOUGH --

THE COURT: NOT 200 TIMES. 200 PERCENT. I'M SORRY.

MR. BRACKEN: I THINK WHAT HE SAYS, THOUGH --

THE COURT: EVEN MR. CARMODY CAN GET WITHIN 200 TIMES OF SOMETHING.

MR. BRACKEN: -- THAT THE PRINTS HAVE NO VALUE. I MEAN, I THINK HE'S LOOKING AT ALL --

THE COURT: HE SAYS THEY'RE WORTHLESS. HE SAYS THEY HAVE NO VALUE.

MR. BRACKEN: YES.

THE COURT: BUT HE SAYS THAT BASED ON ASSUMPTIONS OR PREMISES WHICH ARE NOT APPLICABLE TO THE ENTERPRISE IN THIS CASE, CITING LARGELY ANECDOTAL MATERIAL THAT, WHILE

INTERESTING, IS ONLY ONE NARROW NICHE OF THE IMAGE MARKET.

HE TALKS ABOUT THE -- WHAT I WOULD CALL FINE ART. AND I GUESS THE ONLY REASON I'D CALL IT THAT IS HE'S TALKING ABOUT EXPENSIVE ART. AND I REALIZE THAT'S NOT THE SAME THING, BUT HE'S TALKING ABOUT EXPENSIVE PRINTS, FOR THE MOST PART. AND THE QUOTATIONS IN HIS APPRAISAL ARE IN THE THREE TO $5,000 RANGE. THEN HE GETS DOWN TO THE THREE TO $500 RANGE, WHICH HARDLY ADDRESSES THE BACKS OF PLAYING CARDS AND OTHER USES OF IMAGES.

AND I DON'T MEAN TO BE DIRECTING THIS TO YOU, COUNSEL, BECAUSE I RECOGNIZE IT WAS ALL DONE A LONG TIME AGO. BUT THERE'S NOTHING FROM THAT -- UNLESS I SIMPLY ACCEPT UNCRITICALLY, WHICH I CANNOT DO, HIS PREMISES, THERE IS NOTHING TO INDICATE THE VALUE OF THESE PRINTS AS 200 PERCENT -- THE VALUE PUT ON BY THE PLAINTIFFS IS 200 PERCENT

OF THEIR FAIR MARKET VALUE AND THAT FOR ANY COMMERCIAL USES THEY LACKED VALUE AT LEAST HALF OF THE TAXPAYER'S EVALUATION.

ANYTHING FURTHER?

MR. BRACKEN: NO, YOUR HONOR.

MR. GROSSMAN: THANK YOU, YOUR HONOR.

MAY IT PLEASE THE COURT, WE HAVE PROPOSED AN ORDER THAT THE COURT SHOULD HAVE THAT IT MAY BE ABLE TO SIGN AND DISPOSE IN ORDER TO TAKE CARE OF THE COURT'S ORDER IN THE FILE.

THE COURT: WE'LL DO OUR OWN.

MR. GROSSMAN: THANK YOU, YOUR HONOR.

THE COURT: I HAVEN'T LOOKED AT IT, BUT WE'LL PUT OUT ONE. THANKS.

MR. GROSSMAN: THANK YOU, YOUR HONOR.

(END OF PROCEEDINGS)

I HEREBY CERTIFY THE FOREGOING IS A TRUE AND ACCURATE TRANSCRIPT OF THE PROCEEDINGS.

_____ DATE

_____
YVETTE F. PERRY
OFFICIAL COURT REPORTER

RJS/CERTAPPA

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SAMUEL I. SHUMAN, *et al.*,	§	
	§	
Plaintiffs,	§	
	§	
vs.	§	CIVIL ACTION NO.
	§	H-85-1672
UNITED STATES OF AMERICA,	§	
	§	
Defendant.	§	

FINAL JUDGMENT

It is adjudged that:

1. Samuel I. Shuman recover from the United States of America $1,650 plus interest as provided by law;

2. Adrian M. Shaprio recover from the United States of America $1,800 plus interest as provided by law; and

3. Texanna Art Trading Company, Inc., recover from the United States of America $8,850, plus interest as provided by law.

Signed on September 6, 1988, at Houston, Texas.

/s/
Lynn N. Hughes
United States District Judge

RJS/CERTAPPB

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SAMUEL I. SHUMAN, *et al.*,	§	
	§	
Plaintiffs,	§	
	§	
vs.	§	CIVIL ACTION NO.
	§	H-85-1672
UNITED STATES OF AMERICA,	§	
	§	
Defendant.	§	

ORDER

The plaintiffs' application for an award of costs and attorney's fees is denied.

Signed on January 26, 1989, at Houston, Texas.

/s/
Lynn N. Hughes
United States District Judge

RJS/CERTAPPC

APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SAMUEL I. SHUMAN, *et al.*,	§	
	§	
Plaintiffs,	§	
	§	
vs.	§	CIVIL ACTION NO.
	§	H-85-1672
UNITED STATES OF AMERICA,	§	
	§	
Defendant.	§	

MEMORANDUM ON DENIAL OF ATTORNEY'S FEES

Shuman, Shapiro, and Texanna Art Trading sued the United States of America for the refund of taxes, interest, and penalties assessed against them under 26 U.S.C. § 6700. The plaintiffs were granted a judgment because the government failed to meet its burden of proof in establishing that the plaintiffs overvalued art master-plates to take advantage of a tax shelter.

The plaintiffs have now applied for an award of litigation costs and attorney's fees. The court will deny their application.

Under 26 U.S.C. § 7430, this court may aware certain litigation costs and attorney's fees to a prevailing party when the opposing party's position is unreasonable. The plaintiffs are prevailing parties under § 7430; however, because the application was untimely and no justification has been given for its tardiness, no aware will be made.

Signed on January 26, 1989, at Houston, Texas.

/s/
Lynn N. Hughes
United States District Judge

RJS/CERTAPPD

APPENDIX E

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NOS. 88-6118, 89-2235

SAMUEL I. SHUMAN,
ADRIAN M. SHAPIRO,
and
TEXANNA ART TRADING COMPANY, INC.,

Plaintiffs-Appellants,

versus

UNITED STATES OF AMERICA,

Defendant-Appellees,

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS

(Opinion January 5, 5 Cir., 1990, __F.2d ___)

Before DAVIS and SMITH, Circuit Judges, and LITTLE[1], District Judge

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[1] District Judge of the Western District of Louisiana, sitting by designation.

The plaintiffs in these consolidated cases are Samuel Shuman, Adrian Shapiro and a Texas corporation, Texanna Art Trading Company, Inc. The central issue is the alleged violation by the plaintiffs of a provision of the Internal Revenue Code. To unravel the skein, a recitation of the underlying facts is necessary.

Texanna purchased original lithographic or serigraphic plates from the creating artist. From these plates art prints are produced. The acquisition cost ranged between $44,000 and $85,000 per plate. A small cash payment and a long-term promissory note formed the essential components of each acquisition.

Texanna then sold the master plates to investors for prices ranging between $75,000 and $150,000 per plate. The investor, as owner of the original plate, could then cause the artwork to be printed

and distributed, presumably at a profit. The investor tendered a cash payment, executed one or more short-term promissory notes and a long-term promissory note. For example, Texanna acquired a plate from the original artist for $5,000 cash and a promissory note of $85,000. This plate was then sold by Texanna to an investor for $7,000 cash, and short-term promissory notes totalling $33,000 and a long-term promissory note for $110,000 (R. 90-91 and R. 480-481). The cost or price to the investor is his basis in the asset. That basis is the keystone for claiming depreciation and investment tax credit. If the item is grossly overvalued by the seller, then deductions for depreciation and investment tax credit are unreal and produce distortions when reported by the investor. Intended to curb trafficking by promoters of overvalued investments, often referred to as tax shelters, is Section 6700 of the Internal

Revenue Code. *See*, General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, prepared by the staff of the Joint Committee on Taxation, 31 December 1982 (R. 469). That section imposes a penalty on any person who participates in a plan, arrangement or entity to sell any interest in a plan, arrangement or entity, or furnishes in connection with the sale, a statement with respect to the tax benefits flowing to the purchaser which the person knows is false or fraudulent or "a gross valuation overstatement as to any material matter." The critical term "gross valuation overstatement" is defined in Section 6700(b)(1) as a statement which "exceeds 200% of the amount determined to be the correct valuation...." The penalty of Section 6700 was imposed on the three plaintiff taxpayers for their involvement in

promoting and selling the master plates to various investors.

The taxpayers paid the penalties and filed refund claims which were denied. The taxpayers seek recovery of the penalties paid under protest asserting that they did not make gross valuation overstatements of the master plates or the plans to the investors.

The government's expert witness submitted a report and an affidavit as to the value of the master plates and the plan to be utilized by the investors who would acquire those plates. An essential ingredient to the government's case is proof that the value of the plate and plan as touted by the taxpayers exceeded 200% of the correct value. The taxpayers' motion for summary judgment asserted that the expert report was without foundation and could not form the basis for a factual dispute in that the expert reached the conclusion that the plates were not

subject to valuation. Hence, the government failed to demonstrate that the plates had any value, let alone an excessive value, and therefore, the case should be dismissed. The district court granted summary judgment to the plaintiffs, reasoning in part: "Unless I simply accept uncritically, which I cannot do, his premises, there is nothing to indicate the value of these prints as 200% -- the value put on by the plaintiffs is 200% of their fair market value and that for any commercial uses they lack at least half of the taxpayers' evaluation." (Tr. 18). From that judgment the government appealed.

The reversal of the district court, about to be described, obviates our entertaining the district court's rejection of taxpayers' application for litigation costs and attorney fees as provided by Section 7430 of the Internal Revenue Code.

Viewing, as we must, the evidence and inferences from that evidence in a light most favorable to the government, we conclude that the district court erred in granting the taxpayers' summary judgment motion. The expert witness for the government provided evidence that the art plates were valueless and the arrangement explained to the investor was similarly without value. The evidence proffered by the expert is directed to the critical issue of value of the original plates and the enterprise of investing in acquisition of original plates. The expert concluded in his report that there is "no value to the enterprise outlined in the agreements. Similarly, no value can be estimated for the 'masters' or 'master-plates' since such estimates -- as they relate to enterprise -- would be speculative. The value of the rights implied by the terms 'masters' or 'master-plates' would be the net

income from the sale of the prints produced after the recapture of all expenses other than the price of the rights. Only to the extent that there is income do the rights have value" (R. 349).

Clarifying and amplifying that report, the expert stated, in affidavit form, that "at no point in my report did I consciously wish to convey the impression that I was 'unable' to value the 'master' or 'master-plates' which were the subject of my report..." (R. 150). The affidavit contains this provocative language:

> It is my professional opinion that the term 'master plate' is itself misleading and is atypical to the legitimate art printing industry. Notwithstanding this fact, it is my professional conclusion that, without caveat, the 'master plates' referred to in the private offering Memorandum and Purchase Agreements of Texanna Art Trading Company for 1982 have no value.... Even if Agreements in this case had conveyed normal rights to reproduce, rights to reproduce the images examined for my report would have little or no value. This is

> true because there was and continues to be insufficient demand for limited edition prints, posters, greeting cards, murals and tapestries reproduced from images as those involved in this case. This is due primarily to the fact that the quantity of reproductions and ancillary products which must be sold in order to recoup the cost of manufacture, distribution, promotion, advertisement, and sale of these products would far outstrip demand. Therefore, neither the right to exploit those images nor even the so-called 'master plates' has any value.

The affidavit and report is the product of Richard Alasko, a senior member of the American Society of Appraisers, Personal Property and Fine Art and president of the Alasko Company of Chicago, Illinois. His unassailed circula vitae demonstrate that he is no dilettante. This is a man whose expertise was not subject to question nor distain. The trial judge did not refuse to accept Mr. Alasko as an expert but merely took issue with the fact that a dispute had been presented by his report.

The government's expert presents genuine factual issues which must be resolved by the fact finder. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48, 106 S.Ct. 2505, 2509-10, 91 L.Ed.2d 202 (1986); *Celotex v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed.2d 265 (1986); *Professional Managers v. Fawer, Brian, Hardy and Zatskis*, 799 F.2d 218, 222 (5th Cir. 1986); *St. Amant v. Benoit*, 806 F.2d 1294, 1296-97 (5th Cir. 1987); *Consolidated Metal Products v. American Petroleum Institute*, 846 F.2d 284, 288 (5th Cir. 1988). In granting the summary judgment motion the district court committed reversible error. We therefore REVERSE AND REMAND to the district court for further proceedings.

RJS/CERTAPPE

APPENDIX F

RULE 56. Summary Judgment

(a) FOR CLAIMANT. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in the party's favor upon all or any part thereof.

(b) FOR DEFENDING PARTY. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part thereof.

(c) MOTION AND PROCEEDINGS THEREON. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

(d) CASE NOT FULLY ADJUDICATED ON MOTION. If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court at the hearing of the

motion, by examining the pleadings and the evidence before it and by interrogating counsel, shall if practicable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith controverted. It shall thereupon make an order specifying the facts that appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.

(e) FORM OF AFFIDAVITS; FURTHER TESTIMONY; DEFENSE REQUIRED. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is

competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party.

(f) WHEN AFFIDAVITS ARE UNAVAILABLE. Should it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just.

(g) AFFIDAVITS MADE IN BAD FAITH. Should it appear to the satisfaction of the court at any time that any of the affidavits presented pursuant to this rule are presented in bad faith or solely for the purpose of delay, the court shall forthwith order the party employing them to pay to the other party the amount of the reasonable expenses which the filing of the affidavits caused the other party to incur, including

reasonable attorney's fees, and any offending party or attorney may be adjudged guilty of contempt.

RJS/CERTAPPF